No. 14973

United States
COURT OF APPEALS
For the Ninth Circuit

CLARENCE V. WATSON,

Appellant,

vs.

WOODROW C. BUTTON,

Appellee.

APPELLANT'S BRIEF

Appeal from the United States District Court for the District of Oregon.

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JURISDICTIONAL STATEMENT

The jurisdiction of the United States District Court for the District of Oregon was based upon diversity of citizenship of the parties and the amount in controversy being in excess of $3,000.00, exclusive of costs and interest, (28 U.S.C.A. 1332 (1); R. 3)

This Court's jurisdiction is founded upon its ap-

pellate power over final decisions of the District Courts. (28 U.S.C.A. 1291; R. 51)

STATEMENT OF THE CASE

This case arises on appeal from a final judgment in an equity case wherein appellee brought a direct action to secure an accounting and recover a personal judgment against appellant for corporate monies misappropriated by appellant during his tenure as corporate manager of Highway Freight, Inc., an Oregon Corporation.

The complaint alleged three causes of action, the latter two of which dealt with alleged mismanagement and diversion of corporate opportunity. However, the Court below did not enter judgment on the latter, leaving only the misappropriation of appellant for consideration here. (R. 3 through 12, 51 and 52)

Appellant moved to dismiss the complaint in that it failed to state a claim for relief and for other reasons not urged here. (R. 13)

Thereafter, appellant filed an answer containing several defenses, the only one of any importance here being an incorporation in his answer that the complaint failed to state a claim for relief, and including in his answer a counter-claim for a note

executed by appellee in the amount of $3,000.00. (R. 20, 24, 25 & 26)

Thereafter, appellee filed his reply to the answer, asking that the note be cancelled for fraud on the part of appellant. (R. 27, 28)

The Court then entered an order denying appellant's motion to dismiss, upon which decision had been previously reserved, a pre-trial order was filed, and trial was had, resulting in the Court entering Findings of Fact and Conclusions of Law, and giving judgment in favor of the appellee for $13,945.98, and his costs, and cancelling the note executed by appellee to appellant for fraud, and giving judgment against the appellant on his counterclaim. (R. 29, 14, 30, 46, 51)

Since with the exception of the counter-claim on the note, we admit as true the Findings of Fact of the Court, and since these Findings are identical with the allegations contained in appellee's complaint and in the pre-trial order, we will here summarize these facts for the Court's convenience.

In May, 1951, appellant, an Oregon resident, and appellee, a resident of the State of Washington, purchased 49½ shares of stock each in Highway Freight, Inc., an Oregon Corporation, engaged in the business of a motor carrier for hire. One share

of stock was given to one Earl V. White, Jr., who had no beneficial interest in the corporation. On the same date, these three persons elected themselves directors, and in addition appellant was elected president-treasurer, and given the duties of general manager of the corporation, and acted as such until July, 1954, when all of the stock of the corporation was sold by the parties.

Simultaneously, with this sale, appellant secured as part of the sale, an agreement from the purchasers to release and discharge him from any claims and demands existing against him in favor of the corporation. After this sale, appellee discovered appellant had misappropriated $13,945.98 from the corporation. The present owners of the corporation are not entitled to receive these sums, and have not been damaged thereby, and at this time appellant and appellee are jointly responsible for $68,000.00 in liabilities of the corporation incurred prior to July 20, 1954, the date of the sale.

SPECIFICATION OF ERRORS

1. The District Court erred in failing to dismiss the case in that neither the complaint, agreed statement in the pre-trial order or Findings support a claim for relief, and appellant's motion to dismiss

should have been allowed.

2. The District Court erred in failing to give appellant judgment on his counter-claim.

SUMMARY OF ARGUMENT

1. Misappropriation of corporate money by a corporate officer is a purely corporate cause of action, which must be redressed in the first instance by the Corporation itself, with any judgment recovered being an asset of the corporation. In the event the corporation neglects, refuses or is unable to act, then a derivative action may be maintained by present stockholders or under certain circumstances, the creditors or a trustee in bankruptcy. This type of suit, although initiated by others, is brought through the corporate entity and any monies so secured are assets of the corporation. Appellee, as an ex-stockholder at the time he brought his action, stood as a stranger to this corporate cause of action, which he has been allowed to adopt and secure judgment upon, even though he has affirmatively pleaded and the Court found as a fact that the corporation, which we contend as a matter of law, owned the corporate cause of action and whose property it was, had agreed to release appellant.

2. The fraud alleged by appellee in his defense to appellant's counter-claim shows upon the face of his pleadings to be merely sham, and is not supported by the evidence, and does not constitute fraud in the legal sense of the word.

ARGUMENT

I.

Appellee has stated no claim for relief.

That a corporation is a body politic having a separate existence as a distinct person in law in which the whole corporate property, including its choses in action, is vested, is so well established, that no authority need be cited in support.

That wrongs of the nature here complained of are wrongs against the corporate entity, giving the corporation a primary right to secure their redress, is likewise well established. (Vol 13, Am. Jur., Sec. 1015, page 966.)

That a stockholder may, under proper allegation, bring a derivative action for or on behalf of the corporation to correct abuses by officers of the corporation and to secure for the corporation assets lost because of the wrongful acts of the directors of

the nature here set forth is likewise well established. (Vol. 13, Am. Jur., Sec. 461, page 504, Rule 23 (b), F. R. C. P.)

It is also well established that in order to have the necessary standing to bring a stockholder's derivative suit, one must be a stockholder at the time of bringing the suit and during its continuance. (Ballantine on Corporations, Revised Edition (1946), Page 350)

Accordingly appellee now contends that since he has no standing in Court to secure these monies for the coffers of the corporation because he has sold his stock, and the purchasers have agreed to release the appellant, that he should be allowed to adopt these corporate causes of action and secure the money for his own purse. The principles involved are very ably discussed in the case of Likens v. Shaffer, 64 F. Supp. 432 (1946). (This case was modified 141 Fed. 2d 877, with regard to collateral matters.) In this case, Judge Graven very thoroughly and comprehensively discusses all of the operative principles involved upon which we relied on our motion to dismiss together with the authorities for these principles. Therefore, we will not quote extensively from the case. However, the following are a few of the principles therein enunciated:

The Court quoting from the case of Dillon v. Lee favorably cited therein: "A fraud . . . on the part of the directors or officers of a corporation is an injury done to the corporation itself. . ." "And no individual right of action rests in a stockholder where the directors have caused loss to the corporation through their carelessness and mismanagement. An individual right of action in stockholder against an officer of a corporation can arise only from some private relation, contractual or fiduciary, as distinguished from a purely corporate relation common to all of the stockholders."

"The fact that a stockholder owns all or practically all or a majority of the stock in a corporation does not permit him to sue as an individual for a wrong done to the corporation."

In this case, the Court also discusses the case of Smith v. Bramwell, 1934, 146 Ore. 611, 31 Pac. 2d 647. Wherein the Oregon Supreme Court states flatly: "It is a well established rule that a stockholder of a corporation has no personal right of action against directors or officers who have defrauded or mismanaged it and thus effected the value of its stock. The wrong is against the corporation and the cause of action belongs to it. Any judgment obtained by reason of such wrongs is an asset of the corporation which enures first to the benefit of the

creditors and secondly to the benefit of the stockholders."

Although we do not pretend to know all the reasons for this particular rule, we submit that some of the more cogent would be as follows:

1. A judgment obtained by the stockholder would not serve to be a bar to another suit brought by the creditors acting through the corporation on the theory that the money misappropriated from the corporation is part of the trust fund available to the creditors.

2. Appellant had no opportunity to present any counter-claims accruing to his benefit against the corporation, or to plead the corporate release in bar.

3. The stockholder could recover the judgment for the full amount of monies misappropriated, spend the money, and leave the other stockholders and creditors holding the sack.

It is interesting to note in this respect that appellee was given judgment for the entire amount of money misappropriated.

It would appear to be common sense that in any event he would not be entitled to more than 49½ per cent of these corporate monies even were he able to maintain the action. The Court has given

judgment to appellee not only for his own 49½ per cent of the corporate monies taken, but also appellant's share of 49½ per cent, which by virtue of his former stockholdings in the corporation, he would be equally entitled if appellee's theory of the case were followed.

To put it in another way, part of appellee's judgment represents money which appellant misappropriated from himself. The only rationale which we feel could be proferred in support of this, would be to contend that appellant is such a villain that he does not deserve any consideration.

II.

The Court erred in failing to give appellant judgment on his counter-claim for the $3,000.00 note executed by appellee.

At the outset, it will be noted that appellee in the agreed statement of facts in the pre-trial order admits all material allegations of appellant's counter-claim regarding the note. (R. 32) Thus leaving only the issue of fraud either in the inducement or execution of the note to bar appellant's recovery.

Appellee further admits in his testimony that the truck sold to him by appellant, which constituted

consideration for the note, was worth the money, and that there were no false representations involved in the sale regarding the truck itself. (R. 57, 58)

Actually what appellee is saying when he claims fraud is this: "Because appellant did not tell me of his misappropriation of the corporate funds, I bought a truck from him, and even though this truck was worth the money, because I sold it to a third party who is paying me what I agreed to pay appellant on my note I should not have to pay for the truck because appellant didn't tell me that he misappropriated these corporate monies."

We submit that this is highly improper, and under no circumstances, should appellee have been allowed cancellation of the note.

He admits that the consideration of the note, i.e. the truck, was worth the money, and admits that he has been receiving payments for the resale. He admits that the note is in default, and even if the misappropriation were a legal cause of cancellation of the note, there would still be the fact remaining that appellee was not damaged.

We submit, further, that the misappropriation had nothing whatsoever to do with the transaction concerning the truck, and as a result of the Court's cancelling the note, the appellee is placed in the

enviable position of not only receiving full judgment for the matters complained of constituting the fraud as a defense, but also getting appellant's truck or at least the fruits thereof in the bargain.

CONCLUSION

The decision of the United States District Court for the District of Oregon should be reversed, and this case should be remanded for further proceeding in accordance with the opinion of this Court.

Respectfully submitted,

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